

**Memorandum**

Date

JUL 12 2001  
Thomas D. Roslewicz

From

Deputy Inspector General  
for Audit Services

Subject

Review of Administrative Costs Included in the Adjusted Community Rate Proposal for a  
Missouri Medicare+Choice Organization (A-07-00-00114)

To

Neil Donovan  
Director, Audit Liaison Staff  
Centers for Medicare and Medicaid Services

Attached are two copies of our final report entitled, "Review of Administrative Costs Included in the Adjusted Community Rate Proposal for a Missouri Medicare+Choice Organization."

We suggest that you share this report with the Centers for Medicare and Medicaid Services (CMS)<sup>1</sup> components involved in the Medicare managed care organization (MCO) operations, particularly the Center for Health Plans and Policy. The report presents the results of our review of the administrative cost component of the adjusted community rate (ACR) proposal submitted to CMS by a Missouri Medicare+Choice contractor (the Plan) for Contract Year (CY) 2000. The objective of our review was to assess whether the administrative costs submitted by the Plan on its ACR proposals were appropriate when considered in light of the Medicare program's general principle of paying only reasonable costs. This review is part of a nationwide review of administrative costs included in the ACR proposals that was requested by CMS.

In an Office of Inspector General (OIG) audit report issued in January 2000,<sup>2</sup> we identified \$66.3 million of administrative costs that were included in the ACR proposals submitted by nine MCOs. These administrative costs would have been unallowable had the MCOs been required to follow Medicare's general principle of paying only reasonable costs. We recommended that CMS pursue legislation concerning MCOs' administrative costs which would require risk-based MCOs to follow Medicare's general principle of paying only reasonable costs. In response to our report, CMS did not concur with the recommendation.

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<sup>1</sup>Formerly known as the Health Care Financing Administration.

<sup>2</sup>Review of the Administrative Cost Component of the Adjusted Community Rate Proposal at Nine Medicare Managed Care Organizations for the 1997 Contract Year (A-03-98-00046)

The CMS noted that it had recently revised the ACR methodology and that the new procedures will be reviewed to ensure the effectiveness of reducing the administrative burdens on the MCO.

However, based on the results of our audits at the nine MCOs, CMS requested that OIG examine other MCOs to determine if administrative costs, that would be deemed unallowable under Medicare's reasonable cost principles, were included in the computation of the ACR proposals under the revised format. This review is in response to CMS' request.

The Medicare ACR process is designed for Medicare+Choice organizations (M+CO) to present to CMS their estimate of the funds needed to cover the costs of providing the Medicare package of services to any enrolled Medicare beneficiary. An M+CO's anticipated or budgeted funds are calculated to cover direct medical care, administration, and the additional revenues (e.g., profits) of the Plan for the upcoming year and must be supported by the individual M+CO's operating experiences related to utilization and expenses. Beginning in CY 2000, M+COs were required to use their actual Medicare costs (base year) in developing their ACRs. For CY 2000, the base year was 1998.

Presently, there is no statutory or regulatory authority governing allowability of costs in the ACR process, unlike other areas of the Medicare program. For example, regulations covering MCOs that contract with CMS on a cost reimbursement basis provide specific parameters delineating allowable administrative costs for enrollment and marketing. These same guidelines, however, are not used in administering the Medicare+Choice contracts.

This review showed \$151,049 in costs or \$0.38 per member per month could have been eliminated when computing the ACR if Federal Acquisition Regulations<sup>3</sup> (FAR) Contract Cost Principles were applied to M+COs. These costs include promotional giveaways, donations and sponsorships, and lobbying and entertainment. The effect of including these costs in the Plan's ACR proposals was to increase the amounts needed for administration, thus reducing any potential excess from the Medicare payment amounts. In addition, this methodology impacted the amount available to Medicare beneficiaries for additional benefits or reduced premium amounts. However, because of a lack of criteria for inclusion of administrative costs on the ACR proposals, there were no recommendations addressed to the Plan regarding this issue.

The review also showed administrative costs were understated. This understatement occurred because the Plan (1) did not allocate a fair share of management fees to Medicare and (2) did not follow instructions for reporting reinsurance premiums and user fees.

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<sup>3</sup>The FAR is the primary regulation for use by all Federal Executive agencies in their acquisition of supplies and services with appropriated funds. Part 31 contains cost principles and procedures for (a) the pricing of contracts, subcontracts, and modifications to contracts and subcontracts whenever cost analysis is performed and (b) the determination, negotiation, or allowance of costs when required by a contract clause.

The M+CO's understatement of Medicare administrative costs did not result in increased costs to beneficiaries through increased premiums or a decrease in beneficiary services. However, there could be instances on future proposals where misreporting administrative costs could have adverse consequences for plan members.

While this review examined only one plan, we believe that our results of this Plan, and others previously issued, continue to highlight a problem - administrative costs deemed unallowable under Medicare's reasonable cost principles are being paid with Medicare funds. We are continuing our reviews at other M+COs. The results of these reviews will be shared with CMS in the coming months so that appropriate legislative changes can be considered.

The Plan disagreed with our concept of applying FAR to M+COs in general and ACR proposals in particular. The Plan felt that the amount of potential unallowable costs identified by the OIG could have been reduced further if the Plan was given the opportunity to review the OIG's work. Also, the Plan felt that costs included by the OIG as unallowable would be considered allowable under FAR.

Although FAR principles do not currently apply to M+COs, we believe that applying reasonable cost principles in the review of administrative costs identifies costs that should have been spent for extra additional benefits. We do not agree with the Plan's statement regarding the opportunity to review the OIG's work. We gave Plan officials numerous detailed audit workpapers that would have allowed the Plan to perform an independent review of the unallowable items identified by the OIG. We do not believe any unallowable amounts we identified would be allowable under FAR principles.

Please advise us within 60 days on actions taken or planned on our recommendations. If you have any questions, please contact me or have your staff contact George M. Reeb, Assistant Inspector General for Health Care Financing Audits, at (410) 786-7104.

To facilitate identification, please refer to Common Identification Number A-07-00-00114 in all correspondence relating to this report.

Attachments

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF ADMINISTRATIVE  
COSTS INCLUDED IN THE ADJUSTED  
COMMUNITY RATE PROPOSAL FOR A  
MISSOURI MEDICARE+CHOICE  
ORGANIZATION**



**JULY 2001  
A-07-00-00114**

**Memorandum**

Date

From

Subject

JUL 12 2001  
*Thomas D. Roslewicz*  
Thomas D. Roslewicz  
Deputy Inspector General  
for Audit Services

To

Review of Administrative Costs Included in the Adjusted Community Rate Proposal for a Missouri Medicare+Choice Organization (A-07-00-00114)

Neil Donovan  
Director, Audit Liaison Staff  
Centers for Medicare and Medicaid Services

This final report presents the results of our review of the administrative costs included in the adjusted community rate (ACR) proposals submitted to the Centers for Medicare and Medicaid Services (CMS)<sup>1</sup> for the 2000 Medicare Contract Year (CY) by a Missouri Medicare+Choice (M+C) contractor (the Plan). We suggest that you distribute this report with CMS components involved in the Medicare managed care organization (MCO) operations, particularly the Center for Health Plans and Policy. This review is part of a nationwide review of administrative costs included in the ACR proposals that was requested by CMS.

The objective of our review was to examine the Plan's administrative cost component of its ACR proposals, and assess whether the costs were appropriate when considered in light of the Medicare program's general principle of paying only reasonable costs.

In an Office of Inspector General (OIG) audit report issued in January 2000,<sup>2</sup> we identified \$66.3 million of administrative costs that were included in the ACR proposals submitted by nine MCOs that would have been unallowable had the MCOs been required to follow Medicare's general principle of paying only reasonable costs. We recommended that CMS pursue legislation concerning MCOs' administrative costs which would require risk-based MCOs to follow Medicare's general principle of paying only reasonable costs. In response to our report, CMS did not concur with the recommendation. The CMS noted that it had recently revised the ACR methodology and that the new procedures will be reviewed to ensure the effectiveness of reducing the administrative burdens on the MCO.

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<sup>1</sup> Formerly known as the Health Care Financing Administration.

<sup>2</sup> Review of the Administrative Cost Component of the Adjusted Community Rate Proposal at Nine Medicare Managed Care Organizations for the 1997 Contract Year (A-03-98-00046)

However, based on the results of our audits at the nine MCOs, CMS requested that OIG examine other MCOs to determine if administrative costs, that would be deemed unallowable under Medicare's reasonable cost principles, were included in the computation of the ACR proposals under the revised format. This review is in response to CMS' request.

The Medicare ACR process is designed for Medicare+Choice organizations (M+CO) to present to CMS their estimate of the funds needed to cover the costs of providing the Medicare package of services to any enrolled Medicare beneficiary. An M+CO's anticipated or budgeted funds are calculated to cover direct medical care, administration, and the additional revenues (e.g., profits) for the upcoming year and must be supported by the individual M+CO's operating experiences related to utilization and expenses. Beginning in CY 2000, M+COs were required to use their actual Medicare costs (base year) in developing their ACRs. For CY 2000, the base year was 1998.

Presently, there is no statutory or regulatory authority governing allowability of costs in the ACR process, unlike other areas of the Medicare program. For example, regulations covering MCOs that contract with CMS on a cost reimbursement basis provide specific parameters delineating allowable administrative costs for enrollment and marketing. These same guidelines, however, are not used in administering the M+C contracts.

Based on our audit, \$151,049 in costs or \$0.38 per member per month (PMPM) could have been eliminated when computing the ACR if Federal Acquisition Regulations<sup>3</sup> (FAR) Contract Cost Principles were applied to M+COs. These costs include promotional giveaways, donations and sponsorships, and lobbying and entertainment. The effect of including these costs in the Plan's ACR proposals was to increase the amounts needed for administration, thus reducing any potential "excess" from the Medicare payment amounts. In addition, this methodology impacted the amount available to Medicare beneficiaries for additional benefits or reduced premiums. However, because of a lack of criteria for inclusion of administrative costs on the ACR proposals, there were no recommendations addressed to the Plan regarding this issue.

The review also showed administrative costs were understated. This understatement occurred because the Plan (1) did not allocate a fair share of management fees to Medicare and (2) did not follow instructions for reporting reinsurance premiums and user fees.

This audit was part of a nationwide review of administrative costs included in the ACR proposals. Based on the results of the individual reviews, recommendations will be made directly to CMS.

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<sup>3</sup>The FAR is the primary regulation for use by all Federal executive agencies in their acquisition of supplies and services with appropriated funds. Part 31 contains cost principles and procedures for (a) the pricing of contracts, subcontracts, and modifications to contracts and subcontracts whenever cost analysis is performed and (b) the determination, negotiation, or allowance of costs when required by a contract clause.

On June 5, 2001, the Plan responded to a draft of this report. The Plan disagreed with our concept of applying FAR to M+COs in general and ACR proposals in particular. The Plan also felt that, given the opportunity to review the OIG's work, the amount of potential unallowable costs could have been reduced further. The Plan stated that other costs included by the OIG as potentially unallowable, would actually be allowable under FAR. We have summarized the Plan's response along with our comments after the Findings and Recommendations section of this report. The Plan's written response is included as an attachment to this report.

## **INTRODUCTION**

### **BACKGROUND**

#### **Medicare Overview**

Under Title XVIII of the Social Security Act, the Medicare program provides health insurance to 39 million Americans age 65 and over, those who have permanent kidney failure, and certain people with disabilities. Within the Department of Health and Human Services, the Medicare program is administered by CMS.

Medicare includes two related health insurance programs, hospital insurance, or Part A, and supplementary medical insurance, or Part B. Part A includes inpatient hospital, skilled nursing, rehabilitation, home health, and hospice services. Part B includes physician and outpatient hospital services and durable medical equipment.

The Balanced Budget Act of 1997 (P.L. 105-33) established Part C of the Medicare program, M+C. Starting in November 1999, the M+C program began offering Medicare beneficiaries a variety of health delivery models, including M+COs such as health maintenance organizations, preferred provider organizations, and provider sponsored organizations.

#### **ACR Proposal**

The M+COs are required by section 1854 of the Social Security Act to compute an ACR proposal and submit it to CMS prior to the beginning of the M+CO's contract period. The ACR proposal is prepared by an M+CO to justify its pricing structure for a benefit package offered to beneficiaries. The ACR proposal itemizes the costs for the benefit package provided by the M+CO, including administrative costs. The ACR requirement is designed to ensure that Medicare beneficiaries are not overcharged for the benefit package being offered.

The CMS introduced revised instructions for completing the ACR in February 1998. One ACR proposal must be submitted for each health plan the organization intends to market. The ACR incorporates the revenue requirements of all its plans. The CMS believes that the

revised ACR will more accurately reflect the actual costs in pricing a benefit package. The CY 2000 ACRs were based on 1998 actual costs for both non-Medicare and Medicare enrollees.

## **SCOPE**

The objective of the review was to examine the administrative cost component of the CY 2000 ACR proposals submitted by the Plan, and assess whether the costs were appropriate under Medicare's general principle of reasonableness. To accomplish our objective we:

- reviewed the applicable laws and regulations;
- discussed with the Plan officials their ACR proposal process and the calculation of administrative costs in its CY 2000 ACR proposals; reviewed the National Data Reporting Requirements reports; and
- selected categories of administrative costs from the Plan's 1998 general ledger. The selected cost categories have historically been problematic areas in the Medicare fee-for-service program.

From total administrative costs of \$52,005,916 reflected in the Plan's Fiscal Year 1998 financial statements, we judgementally selected 37 administrative cost accounts totaling \$5,128,442 for review. We then reviewed each of these accounts using the guidelines CMS applies to cost-based MCOs and Medicare fee-for-service carriers, intermediaries, and providers, since CMS guidance does not specify which administrative costs may be included in an ACR proposal.

The review was performed in accordance with generally accepted government auditing standards. The objective of the review did not require us to review the internal control structure of the Plan. Because we reviewed a judgmental sample, our findings cannot be projected to the universe of administrative costs submitted by the Plan. Field work was performed at the Plan's offices.

## **FINDINGS AND RECOMMENDATIONS**

Our review showed that \$151,049 in costs (\$0.38 PMPM) could have been eliminated when computing the ACR if FARs were applied to M+COs. The review also showed administrative costs were understated. This understatement occurred because the Plan (1) did not allocate a fair share of management fees to Medicare and (2) did not follow instructions for reporting reinsurance premiums and user fees.



## **COSTS THAT WOULD BE INAPPROPRIATE UNDER FARS**

Of the \$5,128,442 in administrative costs selected for review, we identified costs of \$151,049 which we believe were not appropriate when compared to the Medicare program's general principle of paying only reasonable costs. We reviewed each of the selected costs using the guidelines CMS applies to cost-based MCOs and Medicare fee-for-service carriers, intermediaries, and providers. If existing Medicare regulations were applied to M+COs, we believe the following types of costs would not be allowable:

- **Donations and Sponsorships** - (\$65,473) Included donations to March of Dimes Golf Classic, the YMCA senior prom, the Arthritis Foundation grand prix, March of Dimes Walk-a-thon, and sponsorship of Older Adults Services Information Systems program.
- **Entertainment** - (\$42,679) Included golf club dues, food and tickets for professional baseball games, coffee supplies, concert tickets, and meals for numerous meetings.
- **Promotional Giveaways** - (\$31,592) Costs included a variety of logo items such as frisbees, pill organizers, ink pens, and letter openers.
- **Lobbying** - (\$11,305) Included services of professional lobbying firms and a portion of insurance association dues attributable to lobbying.

The effect of including these costs in the Plan's ACR proposals was to increase administrative costs for CY 2000, thereby reducing any potential excess from the Medicare payment amounts. In addition, this methodology impacts the amount available to Medicare beneficiaries for additional benefits or reduced premium amounts.

## **CONCLUSION**

Our review showed that certain costs included in the Plan's administrative cost component of the ACR proposals were inconsistent with the Medicare program's general principle of paying only reasonable costs. While we recognize that, unlike other areas of the Medicare program, there is currently no statutory or regulatory authority governing the allowability of administrative costs in the ACR process, we question the equity of including costs in the ACR process that are unallowable in other facets of the Medicare program.

## **OTHER MATTERS**

We determined the Medicare administrative costs reported on the Plan's ACR proposals were understated. This understatement occurred because the Plan did not allocate a fair

share of management fees to Medicare and did not follow instructions for reinsurance premiums and user fees. Costs excluded from administration included:

- **Management Fees** - The M+CO reported all corporate management fees in non-Medicare administrative expense on the ACR proposals. We believe a portion of the total amount represents Medicare's fair share of management fees and should be moved from non-Medicare to Medicare administration to accurately reflect the corporate office costs associated with the M+CO's Medicare operation. In addition, we believe the Plan should have allocated a portion of the total management fees based on the Medicare to non-Medicare ratio used to develop total administrative expenses.
- **Reinsurance Premiums and User Fees** – The CMS instructions require that both reinsurance premiums and user fees be reported in administration on the ACR proposals. However, the M+CO recorded netted amounts in premium revenues on their audited financial statements and failed to properly classify these items in administrative expense for CMS reporting purposes.

## CONCLUSIONS

We believe the use of Medicare trust funds to pay monthly M+CO capitation payments should not exceed an amount that would be allowed using existing regulations applied in other areas of the Medicare program that include prudent and cost-conscious management concepts. Notwithstanding the lack of specific guidelines for M+COs, we believe that those costs that would not be allowable under other areas of the Medicare program should be eliminated from the Medicare ACR calculation.

However, because the elimination of unallowable administrative costs from the ACR computation is not currently a requirement applicable to M+COs, we made no recommendations to the Plan regarding this issue. Instead, the results of this review, along with similar reviews at other M+COs, will be shared with CMS so that appropriate legislative changes can be considered.

The M+CO's understatement of Medicare administrative costs did not result in increased costs to beneficiaries through increased premiums or a decrease in beneficiary services. However, there could be instances on future proposals where misreporting administrative costs could have adverse consequences for plan members.

## The Missouri Plan's Comments

The Plan disagrees in principle with the OIG's concept of applying FAR to M+C organizations in general and ACR proposals in particular. In this regard, the Plan noted that FAR principles (reasonable costs) do not currently apply to M+COs, and that appropriate Medicare guidelines were followed in preparing their 2000 ACR proposal.

The plan was pleased with the relatively low rate of potentially unallowable administrative costs, and stated that, had they been offered by the OIG the opportunity to conduct a detailed review of the OIG's findings, they believe they could have reduced this amount even further.

The plan believes the OIG findings regarding FAR unallowable costs are overstated by the inclusion of certain enrollment and marketing type costs that, according to the Plan, are necessary to perform the business functions required by CMS. The Plan also contended that certain other of the OIG's unallowable costs, which they described as public or community service, office supplies and employee morale, would have been allowable under FAR.

The full text of the Plan's comments has been included as an Attachment to this report. Names, addresses and other material in the response that would identify the Plan have been excluded to protect the Plan's anonymity.

### **OIG'S Response**

We believe that the concept of reviewing administrative costs using reasonable cost principles is a worthwhile auditing procedure. For example, applying reasonable cost principles in our assessment of administrative costs resulted in identification of costs that should have been spent for extra additional benefits. Furthermore, we were careful to state in the report that the FAR does not currently apply to risk type MCOs. It should be noted that CMS requested, as was mentioned in the report, that the OIG review administrative costs using the FAR as criteria.

We do not agree with the Plan's implication that the OIG denied the Plan the opportunity to conduct a detailed review of the OIG's findings. Plan officials requested and were provided a number of detailed audit workpapers that we believe would have allowed the Plan to perform their own independent review of OIG "unallowable" items. As to whether such a review would have reduced the amount of "unallowables" reported by the OIG, we believe our reported amounts represent a fair and conservative interpretation of costs that may not have been allowable under FAR criteria.

Regarding marketing-type costs (what we classified as "promotional giveaways"), we acknowledge that CMS guidelines permit gifts of nominal value (limited to \$10 per event per beneficiary) under certain conditions and with certain restrictions. However, we believe if the Plan had not spent these sums on promotional giveaways, it could have provided extra additional benefits to Medicare beneficiaries. Providing the maximum possible benefits, in our opinion, is the best strategy for attracting and keeping members.

Furthermore, the Plan's response did not provide any detail examples to support their contention that the OIG unallowable amounts included public or community service, office supplies and employee morale costs that would have been allowable under FAR. We do not believe the reported "unallowable" amounts include any such types of costs that would be allowable under a fair interpretation of FAR principles.

**Note**

The Plan did not respond directly to the finding discussed under "other matters." This finding refers to the fact that the Plan did not allocate a fair share of management fees to Medicare and did not follow instructions for reinsurance premiums and user fees.

[REDACTED]

June 5, 2001

OIG Note: All information identifying the name and address of the MCO was deleted from the MCO's response.

James P. Aasmundstad  
Regional Inspector General for Audit Services  
Department of Health and Human Services  
Office of Inspector General  
Region VII  
601 East 12<sup>th</sup> Street  
Room 284A  
Kansas City, MO 64106

RE: Response to Draft Audit Report, No. A-07-00-00114

Dear Mr. Aasmundstad:

Thank you for the opportunity to respond to and comment on the above-referenced Draft Audit Report regarding our Medicare+Choice organization's ("M+CO" or the "Plan") 2000 Adjusted Community Rate ("ACR") Proposal. I understand that this response will be included in the final report presented to the Health Care Financing Administration ("HCFA") with Plan-identifying information removed before dissemination.

On behalf of our Plan, I would like to offer several comments to this Draft Audit Report. At the outset, although we understand the issue, we disagree with the OIG's ultimate goal of applying the Federal Acquisition Regulations ("FAR") to M+COs. It seems to us that the use of the FAR in the context of M+C Organizations in general, and the ACR proposals in particular, is inappropriate. However, even if the FAR had been applied, we are obviously pleased that the OIG's audit identified no more than .3 percent of the Plan's total administrative costs as potentially unallowable. Although we were not offered by the OIG the opportunity to conduct a detailed review of the OIG's findings, we nonetheless believe that we could reduce this small percentage even further. In any event, as noted by the OIG in the Draft Audit Report, the FAR cost principles do not presently apply to M+COs. *Draft Audit Report at 1.* Thus, we appropriately followed the relevant Medicare guidelines in preparing our 2000 ACR proposal.

The OIG's audit applies the regulations that govern cost allowability in other government-contracting contexts to Medicare+Choice contracts. Our understanding is that there are certain types of costs that would be unallowable under the FAR, such as certain enrollment and marketing costs, but which are expressly allowable under the Medicare cost principles and

which are necessary to perform the business functions required by HCFA of the Plan. Compare 48 C.F.R. § 31.205-1 (d) and 42 C.F.R. § 417.538. Thus, in our opinion, by taking this approach, the OIG overstates the costs that would be treated as unallowable.

The OIG also overlooks the uniqueness of what the M+C Plan is being asked to do on behalf of HCFA for Medicare beneficiaries. There are certain distinctions between the government's contract with M+COs and those contracts to which the FAR normally applies. Again we believe the OIG is applying to M+COs the same cost principles the Federal government applies to defense contractors, which we do not see as comparable to M+COs.

In particular, the provisions of the FAR are inconsistent with the M+C regulations,<sup>1</sup> the Medicare Health Maintenance Organization Manual (HCFA Publication 75) and the Medicare Managed Care National Marketing Guide, which all allow marketing and promotional activities by M+COs that would not be permitted as allowable contract activities under the FAR. For example, Section 2200 of the Medicare Health Maintenance Organization Manual states: "Marketing includes activities undertaken by an HMO/CMP to generate good will, *encourage individuals to enroll in or remain in a prepaid health plan*, or to provide information on plan benefits or costs and membership rules." (Emphasis added.) Another Section of the Manual is entitled, "Medicare Required Marketing Activities". Manual § 2201. Thus, HCFA contemplated the need for marketing by M+COs and encourages M+COs to undertake marketing efforts to increase and maintain enrollment in money-saving managed care plans.<sup>2</sup> Marketing is not often a function procured by the federal government from defense contractors.

In addition, like all government contractors, M+COs enter into their contracts with the government voluntarily. However, unlike other government contractors, the M+CO's success as a contractor and HCFA's success in promoting the savings of managed care also is dependent upon a Medicare beneficiary's voluntary enrollment in the M+C Plan. Thus, HCFA is essentially contracting with M+COs for marketing services and sets forth guidance for M+COs to perform these marketing services as well as for covered benefits. In the Medicare Managed Care National Marketing Guide, HCFA states that the Guide is intended to "enable managed care organizations to develop accurate, consumer-friendly, managed care marketing information that will assist [beneficiaries] in making informed health care choices." *National Marketing Guide*,

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<sup>1</sup> See 42 C.F.R. § 422.80. Marketing materials are defined as "any informational materials targeted to Medicare beneficiaries . . . ."

<sup>2</sup> The amount of \$97,065, or 64% of the total amount alleged by the OIG as potentially unallowable administrative costs, is identified as "Donations and Sponsorships". Nearly 100% of the dollar amount attributed to this category is directly related to marketing efforts targeted at senior citizens, and as "Promotional Giveaways". Together, these two categories represent appropriate efforts to market the M+C Plan to the target audience.

The dollar value of the account in question represents purchases of "a variety of logo'd items such as frisbees, pill organizers, ink pens and letter openers," as the OIG properly notes in the Draft Audit Report on page 4. These nominal items are specifically permitted by the Medicare Health Maintenance Organization Manual in Section 2211 and the Medicare Managed Care National Marketing Guide, Chapter 5. These HCFA-approved guides permit gifts worth \$10 or less to potential enrollees, whether or not these individuals enroll in the M+CO.

*Chapter 1.* Thus, HCFA contemplates that M+COs must market their services and promote managed care among Medicare beneficiaries in order to achieve HCFA's intended goal: saving money.

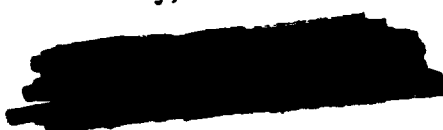

Moreover, M+COs contract with the government on a risk basis, not a cost basis. By agreeing to undertake any potential monetary losses, M+COs are unlike other government contractors to which the FAR applies. Therefore, applying cost-based standards to risk-based contractors could result in monetary losses for M+COs that already assume significant risk. Adding additional administrative burdens that could reduce payments to M+COs would further increase the exodus of M+COs from the M+C Program. As a recent GAO report revealed, M+CO withdrawals from the M+C Program affected almost one million enrollees this year alone. The overall voluntary nature of this particular government program (both voluntary for the M+CO and voluntary for the beneficiary) needs to be taken into account before any such OIG recommendations are seriously considered.

In the case of this Plan, the 2000 ACR proposal was prepared and submitted to HCFA in accordance with the relevant Medicare guidelines for such a submission. The OIG does not challenge the completeness or accuracy of the Plan 2000 ACR proposal in the form in which it was filed under the relevant Medicare guidelines.

In the Draft Audit Report, the OIG has indicated that \$151,049 "could have been eliminated . . . if [FAR] Cost Contract Principles were applied to risk-based MCOs." *Draft Audit Report at 1.* The fact, however, is that the FAR do not apply to M+COs or the ACR proposal process and none of this dollar amount should be eliminated from the ACR. *Draft Audit Report at 1.* Even if the FAR were applied to the Plan's 2000 ACR proposal, the auditors found only .3 percent of the total administrative costs potentially might have been found to be unallowable. However, it appears that certain of these costs would be allowable even under the FAR as public service or community service activities, office supplies or employee morale, among others.

We appreciate the opportunity to respond to and comment on the Draft Audit Report. Please feel free to contact me if you have any questions concerning this letter.

Sincerely,

  
  
President & CEO  
